Forming a Philanthropic Foundation

Issues Paper prepared for

The Morgan Family Charitable Trust

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1. INTRODUCTION

The Morgan Family Charitable Trust has asked for some assistance in developing a framework that can act as an objective backdrop to the philanthropic activities it wishes to undertake in coming years. This paper represents an initial look at relevant literature which will assist the development of a framework that will articulate the objectives of the philanthropic activities, provide a method for setting priorities and provide a mechanism for explaining/justifying the decisions and actions of the fund.

The paper is split into three sections

Lessons: a review of relevant literature

Structure: a first attempt at putting together a structure for the foundation

Questions: a list of critical questions that members of the Trust will need to address in order to determine the actual structure, rules and objectives of the proposed Morgan Family Charitable Foundation.

2. LESSONS

Problems with giving

A recent survey article in the Economist magazine (Bishop 2006) has noted a new wave of philanthropists coming predominantly as a result of the new wealth gained in technology based industries. This new influx of capital is arriving at a time when surveys show that in many countries the public's trust in philanthropic organisations is falling, and there are growing worries that donations will not be put to good use (Bishop, p6). Bishop quotes Rob Reich:

> American tax breaks are of most benefit to things like elite schools, concert halls and religious groups: "We should stop kidding ourselves that charity and philanthropy do much to help the poor."[1]

A series of scandals at philanthropic foundations – mostly over excessive pay, jobs for family members and extravagances – has attracted the ire of Congress, which is threatening tough new legislation. But as Bishop quotes Michael Porter:

> "Foundation scandals tend to be about pay and perks, but the real scandal is how much money is pissed away on activities that have no impact. Billions are wasted on ineffective philanthropy."

With an influx of new money into the giving industry from self-made business people there are moves afoot to improve the effectiveness of philanthropic activities. The buzz is about maximising the leverage of donors' money. Even the exceedingly rich recognise that personal wealth is dwarfed by the financial resources at the disposal of governments and in the for-profit market place. To make a real difference, philanthropists increasingly recognise the need to concentrate their resources on problems that are not being dealt with by governments or for-profit organisations. By not being constrained by voters or shareholders, philanthropists can take risks to find pioneering solutions that can then be adopted on a larger scale by governments or for-profit firms.

But as Bishop notes, being "business like" is not sufficient to ensure good use of philanthropic funds: most businesses remain mediocre. There are also no market disciplines to force philanthropists to adopt innovations. Indeed the same factors that give the new philanthropists the freedom to adopt innovative approaches also gives them the freedom to ignore pressures to innovate. Bishop also notes that the new rich philanthropists forget that luck may have been important for their success and may have unrealistic expectations about the extent they can make a difference in the philanthropic world.

[1] Rob Reich, "A Failure of Philanthropy", *Social Innovation Review* (Stanford University)

The risk is that the involvement in giving naturally results in further distancing from objective scrutiny. As Ken Gordon, Chief Executive of the Waikato Trust noted in a recent speech:

> "It is very rare for a funder to receive accurate, critical, objective and informed feedback on its operations. It is rare because when we give people money they tend to like us."

Bishop concludes with a four point to-do list:

- Better measurement of the impact of philanthropy;
- Greater transparency of what is being done, what works what doesn't etc;
- A growing recognition that the best way to attract the capital needed to achieve scale is to find potentially profitable ways of solving problems.
- Improve accountability, operational performance and governance structures.

How to maximise leverage

Governance

The first overarching step is to set up good governance structures. This may seem very obvious but its importance can not be overstated and is not necessarily something that is fully recognised in voluntary organisations. Good governance is as critical for fostering strong performance from a philanthropic as it is for any other endeavour. The UK National Hub of Expertise in Governance (ACEVO et al 2005) note the following key principles of good governance in the voluntary sector:

- Board leadership: every organisation should be led and controlled by an effective Board of trustees which collectively ensures delivery of its objects, sets its strategic direction and upholds its values.
- The Board in control: The trustees as a board should collectively be responsible and accountable for ensuring and monitoring that the organisation is performing well, is solvent, and complies with all its obligations.
- The high performance board: The board should have clear responsibilities and functions, and should compose and organise itself to discharge them effectively.
- Board review and renewal: The Board should periodically review its own and the organisation's effectiveness, and take any necessary steps to ensure that both continue to work well.
- Board delegation: The Board should set out the functions of sub-committees, officers, the chief executive, other staff and agents in clear delegated authorities and should monitor their performance.
- Board and trustee integrity: The Board and individual trustees should act according to high ethical standards and ensure that conflicts of interest are properly dealt with.

- The open Board: The Board should be open, responsive and accountable to its users, beneficiaries, members, partners and others with an interest in its work.

In a US study of foundation effectiveness, Ostrower (2004) noted five steps that any foundation, regardless of size or type, should take:

- Develop a clear and specific mission statement
- Establish a clear method by which to evaluate whether or not the foundation is carrying out its mission
- Stay away from the tendency for inertia to set in and undermine the foundation's ongoing commitment to self-assessment.
- Establish a board consensus in tandem with staff to evaluate the foundation in regard to effectiveness.
- Be prepared at any time to produce for itself or others a statement (substantiated by evidence) of how the foundation is performing relative to its mission.

Mission statement

Ken Gordon notes that the most successful and enduring organisations have mission and values statements that have remained remarkably constant over time. It is important that the foundation has a clear mission statement that is signed up to by both board members and staff. The mission statement needs to be sufficiently focussed so that it provides interested parties with a clear understanding about what the foundation is about, provides a first filter on what type of activities fall in and out of the foundation's domain and provides an initial guide to observers about the success of the foundation. On the other hand, the mission statement should not be too narrow that it limits ambition or restricts the foundation from undertaking relevant and worthwhile activities. Finally the mission statement should be reasonably timeless. This is something that should stand up to review with minimal change throughout the life of a foundation.

The mission statement needs to be living and meaningful, the activities promoted need to be consistent with the mission statement, there should be a logical ink between the activities and the mission statement. In essence the mission statement is about the foundation setting its own agenda, about finding and choosing what you want to support rather than having charities find and choose you.

If the mission statement, and its associated values, sets the direction of philanthropic activities this also needs to be backed up with good management and a very clear programme logic, ie the set of logical steps that link the day to day activities with the missions and values.

What types of activities?

Increasingly a distinction is being made between **charity, which is about easing symptoms of distress, and philanthropy, which is about**

investing in solutions to the underlying problems. There is a place for both types of activities. New Philanthropy Capital provides advice on the effectiveness of charities in the United Kingdom note that one can assess the results achieved by philanthropic activities along three dimensions (Lumley 2005):

- Breadth: results can be maximised by reaching as many people as possible.
- Depth: results can be maximised by helping each individual as comprehensively as possible.
- Change: results can be maximised by tackling the causes of the problems, rather than just treating the symptoms.

The aim in assessing a proposed intervention is finding the appropriate balance between these dimensions in order to generate the greatest results. There are obviously some natural trade-offs between some of these dimensions, eg reaching more people may limit the extent of change per individual, addressing the root cause of a problem may prevent problems in the future but may do little to help sufferers today.

In addition to an assessment of results one also needs to analyse the risks that threaten the achievement of desired results and to assess the resources required to deliver the desired results.

Portfolio giving

New Philanthropy Capital promote a portfolio approach to giving. As with financial investing, one can undertake a more effective passive form of giving by investing across a selection of existing charities. This helps to mitigate risk and spreads the type of impact that one can have. For example a balanced portfolio would select a number of charities working on a particular social issue that together:

- Address both short and long term needs
- Work with individuals, communities, services and society
- Work locally, regionally, nationally, internationally
- Treat symptoms and tackle underlying causes.

The key problem with this type of approach is the difficulty in obtaining information for assessing the effectiveness of charities. Some charities are better than others. Directing funds towards the better, more effective charities will maximise the effect obtained from funds given. But assessing effectiveness is not straightforward, the appropriate data may not be available, the lag between treatment and effect can be long, and final outcomes will be affected by many other environmental influences making it difficult to attribute outcomes to any individual influence.

So, given that some charities are more effective than others, it follows that who you choose to support, from a passive giving perspective, makes a large difference on the effectiveness of your giving. But the information collection process determining which charities are most effective is not a trivial or easy task. This makes portfolio investment in the charity sector more difficult than in the financial sector.

The social sectors do not have rational capital markets to channel resources to those who deliver the best results. This is partly a cultural phenomenon, "we are doing good, how can you put a value on goodness", but there is also the lack of a reliable metric – performance is more subjective than in financial markets.

Lumley et al (2005) note that this means that a flexible approach to analysing the performance of charities (based on gathering and incorporating as much data on results as is available) is required. Considerable judgement Hard and fast

The Nonprofit Overhead Cost Project (2004) suggest the following rules for choosing a charity to support:

- Make a list of what you want your money to work on
- Work out how you want to assist: what are the values of the charity? What is the nature of the intervention?
- Is the organisation making a difference?
- Review the operations of preferred charities (review brochures, websites, annual reports). Who is on the Board? How is it organised? How much money does it spend? Where does the money come from? How doe the money get spent?
- Keep records

Note that the proportion of spending on overheads is not regarded as a meaningful criteria for assessing charity effectiveness. Overemphasis on low overheads, far from enhancing the efficiency of charities, has reduced their effectiveness and corrupted their accounting. Indeed by far the more common problem is spending too little on organisational infrastructure that is the foundation for effective programmes over the long term.

Bishop (2006) notes the importance of programme quality for increasing leverage. For example, Teach for America – a non-profit organisation that gets graduates from top universities to spend the first two years of their careers teaching children from low-income families. By selecting only the best applicants, they have fostered both demand of students to be part of the programme and credibility with funders.

Venture philanthropy

The alternative to giving to existing charities or non-profit organisations is to instigate and support the creation of activities that are customised to the interests of the donor. A lot of giving is stimulated by personal experience: showing gratitude for something that helped success; supporting a cause that has had a personal impact (eg a disease suffered by someone close). There may often not be any organisation already in existence that meets the desired outcomes of the donor.

Personal involvement also yields returns to the benefactor that are much deeper than a monetary gift. For example, Herbert Stein recounts his feelings after helping a young blind woman he meets on a bus:

> "That little incident made my day, and several days to follow, golden. I had done a deed of 'lovingkindness'. Lovingkindness is different from charity; charity can be done with money, but lovingkindness requires personal involvement. Lovingkindness yields a greater reward to the giver. 'Sow according to your charity, but reap according to your lovingkindness' (Hosea 10:12). Writing tax-deductible cheques to philanthropic institutions does not make my day golden the way holding that young girl's hand did."
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> Quoted from Saffran B (1998) "Recommendations for Further Reading", Journal of Economic Perspectives, Vol 12, No 2, p241

Also Mark Evans, Head of Family Business and Strategic Philanthropy at Coutts & Co as notes:

> People want to know about the performance of the charities they support. They also want to be personally involved, eg "we thought about getting someone to run our trust, but we really enjoy getting to know the charities personally". (Coppock, 2005)

Venture Philanthropy or High Engagement Philanthropy (HEP) allows funders or investors to become directly and personally engaged and involved with their investment partners beyond providing financial support. Often this engagement takes the form of strategic assistance, eg, long-term planning, board and executive recruitment, coaching, help in raising capital, assuming board roles, accessing networks, etc. HEP funders espouse investment (vs grantmaking) and a deeper investment into a smaller select number of investment partners.

Morino and Shore (2004) note that HEP is about pooling substantial amounts of capital to be invested in a select number of organisations whose leadership and performance promises high rates of social return. Factors important for the success of HEP include:

- Bold ambitions
- Lots of time and money
- Strong leadership
- The vital role of public funding – measure and communicate results in ways that create public will and political support
- Leveraging the funders' networks
- Partnerships and joint ventures
- Exit strategies – approaches vary, but are focussed on finding ways to help their investment partners find a way to fiscal sustainability.
- Coping with how difficult building and scaling organisations can be.

One version of High Engagement Philanthropy is Venture Philanthropy, where the philanthropist provides the seed capital to support social entrepreneurs and social investments. Venture philanthropy has a number of appealing qualities:

- Investment can be focussed on the problem of direct interest to the philanthropist.
- It allows strong personal involvement of the philanthropists and use of their skill set.
- Investment can be directed towards addressing the causes of problems rather than symptoms.
- Support is focussed on the preferred provider rather than on projects (reliance on project specific grants is a perennial problem for non-profit organisations as it imposes significant overhead costs and means uncertainty about the ongoing funding for long term programmes).
- Using venture capital approaches to investing in start-ups allows the philanthropist to explicitly include exit plans into their investment as well as mechanisms to ensure the long run independent viability of the created organisation.
- An exit strategy also means that there is scope to drop losing ideas or ineffective teams. This is a key area where the private sector has outperformed the public sector: not in picking winners but in dropping losers. Potentially though a supported team will be more willing to drop a losing project if it feels that its own viability is not on the line. That is governance needs to reinforce a focus on the ends not just on the means.

An implication of this approach is that it may be more effective to act locally. As with venture capitalism, it is not just money but know how, mentoring, contacts, moral support etc that generates the gains. The venture philanthropist is probably better placed to provide this type of support locally than at a distance.

Portfolio or high engagement?

The Morgan Family Charitable Foundation has expressed an interest in being involved in both hands-on and hands-off philanthropic ventures (Morgan 2006). This view is consistent with the literature reviewed here. But how does one decide what is the appropriate split between the two types of activities? There appear to be a number of factors that will influence this allocation.

First, the personal involvement required in venture philanthropy ventures means that the time that Board members have available and are willing to devote to active ventures will provide a determinant of the extent that ventures are active rather than passive.

Second, active engagement is best suited to local ventures (or at least easily accessible). Direct engagement is thus likely to be limited to ‘local’ causes.

Third the nature of the individual problems being addressed will influence the type of engagement. From finance theory one finances an investment based on the expected life of the investment. Can we translate this maxim to the philanthropic setting? Giving money to address immediate symptoms, a temporary problem, or to solve a discrete problem that requires a one-off intervention is probably best met by a project funding approach (eg up to 3 years). For issues that will take longer to address, eg generational issues, it requires a longer term investment approach, which means investing in the provider institutions, developing long term relationships. The focus in the former is about setting up the project terms of reference, selecting providers, project management, and project evaluation. In the later it is about selecting providers, building up a partnership relationship with preferred provider, setting mutual goals/incentive arrangements, setting up governance arrangements, and monitoring performance.

Who to help

We have noted the importance of setting a clear objective for the Foundation through a well articulated and endorsed mission statement. While the specific aims of the Foundation will depend on the interests and values of the Foundation members, below I discuss a few issues that might help inform the formal setting of the Foundation's objectives.

What are you trying to improve?

Concepts like welfare and happiness are highly intangible. We know they are very important, but they are also very difficult to measure (there is no universally accepted metric), they are highly individualistic (what makes me happy might make you miserable), they are time dependent (what made me happy last year might not work this year), they are also path dependent (ie history matters, eg who gives a gift will influence the pleasure it provides) and so on.

Despite the complexity and our consequent imperfect knowledge of the concepts, analysis is becoming more sophisticated and our knowledge is improving. While economists put a lot of store on revealed preferences (ie that actions speak louder than words and that although people may say one thing this may not be supported by their actions) there is considerable evidence that there is considerable information in subjective, self-assessed measures of happiness and well-being. A recent sophisticated analysis (Kahneman and Krueger, 2006) of the types of activities that induce unhappiness suggests two strategies for reducing misery (defined as reducing the amount of time people spend in an unpleasant emotional state:

1. Focus on mental health interventions for the small segment of the population that spends a great deal of time in an unpleasant state.

2. Focus on time allocation, eg interventions that reduce the amount of time that people spend on unpleasant activities, eg commuting (especially in the morning), housework, childcare, will have a potentially beneficial impact on people's emotional state.

Who are you trying to help?

Should assistance go to relative or absolute disadvantage? For example Hoynes (2006) note that although poverty rates are higher for minority groups, the modal poor individual in the US (42% in 2003) are white non-Hispanics). Such results are not unique to the US. It will be useful to be sure that mission statements and stated values are clear about whether it is the presence of disadvantage or an increased probability of disadvantage are factors that the Foundation wish to address.

What scope?

People's experiences of deprivation or poverty are different. The biggest source of global income inequality is between countries not within countries. Poor economic growth and a lack of wealth subject people from different countries to widely different lifetime prospects. Poverty in first world economies is a different beast to poverty in third world countries. Poverty in poor countries is typically a lifetime sentence, in rich countries it does not need to be.

Being poor in a rich country increases the probability of multiple spells of poverty. For example, Hoynes (2006) notes that around 35% of individuals beginning a spell of poverty will be poor for at least five of the next ten years, with about half of these occurring across multiple spells of poverty. Looking from one perspective this statistic implies considerable concern about the plight of others. But this statistic also highlights (at least to me) the difference between first world and third world poverty. For the vast majority of poor in the US, poverty is a temporary phenomenon, albeit for a significant minority one that will be repeated.

Addressing deprivation in performing economies is about assisting specific sub-populations, in non-performing economies it is about addressing nation-wide issues.

Assessing the size of the problem

The natural altruism of most people can make it difficult to assess the importance of an issue to society. If people have altruistic motives, contingent valuation studies (ie ones where you ask people how much they are willing to pay to solve a problem or provide a public good) are likely to overestimate the benefits of public projects because people will include their altruistic valuations as well as their private valuations.

Such extra altruistic valuations are far from trivial in size. For example, a study cited in Bergstrom (2006) found that a sample of citizens of Greensboro, North Carolina, on average, stated that they were willing to pay about five times as much to reduce a specific health hazard for all members of the state as to reduce this hazard for themselves alone. For a similar benefit to all US citizens they were willing to pay about six times as much as for themselves alone. An implication of this is that asking people to value the importance of a public good has a considerable risk of double counting and overstating its importance.

3. STRUCTURE

The proposed Foundation will require a structure that addresses three forms of operations:

- Fund management – maintaining the financial integrity of the fund, revenue raising and managing the budgets of the donation/operational arms of the fund
- A hands-off portfolio management of grants and donations to existing philanthropic operations
- A hands-on “Venture Philanthropy” operation that identifies strategic gaps in the domain of the Foundation’s interests and which funds and manages the start-up of organisations that will contribute to filling the identified gaps.

Objectives

Below are listed some initial suggestions for the proposed Foundation’s objectives. These are based on my interpretation of the April discussion document of Gareth Morgan

Over arching objective (Mission statement)

To promote the full participation of people in their communities by fostering self-empowerment

Second tier objectives

Promote Foundation values – the importance of families and support for the young so they can participate fully in society.

Salute unsung heroes – bring attention to those who make our lives better

Maximise the leverage of the Foundation

Assist the needy

Foster improvements to the [New Zealand] philanthropic industry, both directly and through providing an example to others.

Rules

Below are presented an initial articulation of potential rules that would govern the operation of the Foundation based on material in the Gareth Morgan discussion document and the current literature review.

Rule	Rationale
Avoid allocating funds based on tax treatment	Reduce risk of donations/assistance not being directed at target groups, of funds allocation based on secondary financial considerations instead of main Foundation aims

Rule	Rationale
Avoid supporting upper/middle class causes	Support for middle class causes would perpetuate the current tax-induced distortions and is inconsistent with aims to maximise leverage from Foundation
Minimise overlap with public provision	The scale of the funds available are very small compared with the government, thus to maximise leverage the Foundation will want to devote money where it will make the biggest difference, which is likely to be in areas where the government is not involved
Minimise duplication of activities undertaken by other philanthropic organisations	For similar reasons as above.
Use of business models for running Foundation activities	To maximise the efficiency, effectiveness and ultimately leverage from the Foundation activities
Define project objectives and map a strategy to achieve objectives	To maximise the efficiency, effectiveness and ultimately leverage from the Foundation activities
Publicise/market projects	Raise public awareness, stimulates a public constituency and generates community momentum to address identified issues (assists maximising leverage aim). Transparency of Foundation activities also promotes internal efficiency and forces Foundation to confront and justify funding decisions. In terms of venture philanthropy activities there will be a requirement to actively market the projects to ensure to ensure the activity generates its own momentum and that the long term success of the project does not rely purely on the direct input and activities of the Foundation.
Focus on project selection	Project selection is seen as critical for ensuring that Foundation leverage is maximised. It is more efficient to spend time selecting the right project than undertaking remedial work to rescue poor performing projects. However this needs to recognise that successful projects require success on a number of dimensions: project aims, project design, strong teams, sound project management and excellent implementation.

4. STRATEGIC QUESTIONS

Objective

1. Is the proposed over-arching objective of the Foundation, "to promote the full participation of people in their communities by fostering self-empowerment", correct?

This suggested over-arching objective is based on interpretation of the April 2006 Discussion Document. Much of the discussion document is about what the Foundation is not about and about the way that the Foundation should be run. It is less clear about what the operations of the Foundation ultimately want to achieve. It is important that the Foundation has a clear mission statement that is signed up to by the Foundation members and its staff. It is also important that this mission statement is narrow enough to provide interested parties with a clear understanding about what the Foundation is about, provides a first filter on what type of activities fall in and out of the Foundation's domain and provides an initial guide to observers about the success of the Foundation. The mission statement should not be too narrow that it limits ambition or restricts the Foundation from undertaking relevant and worthwhile activities. Finally the mission statement should be reasonably timeless. This is something that should stand up to review with minimal change throughout the life of the Foundation.

Operations

The aim is to split the operations of the Foundation into two approaches:

- Operating a hands-off portfolio of philanthropic activities
- Managing hands-on philanthropic ventures

A third operation in finance management, which will comprise activities such as revenue raising and fund management. There are a number of key inter-related strategic decisions that the Foundation will need to address at an early stage:

2. What should the split between portfolio and direct philanthropy activities be?
3. To what extent should the Foundation actively seek external revenue (donations) and how much of its resources should it devote to this?
4. What is the proposed life of the Foundation and, hence, what is the proposed erosion rate of the Foundation's capital base?
5. Should a termination date be set for the Foundation?

Activities

6. Who should undertake the Foundation's activities? Should it have a paid staff, or will it operate through the operation of committees reporting back to the Board?

A key factor answering this question will be the degree to which Foundation members actually want to be involved in the activities. This has two sides, the operations are time consuming, but active involvement also generate a greater sense of gratification and sense of achievement to the donors.

7. What is the desired split in activities between addressing symptoms and causes
8. What is the desired split in activities between addressing New Zealand and world issues?

The answer to these two questions will influence decisions about the balance between portfolio and high engagement activities as high engagement will necessarily require more input of time from the donors, need to be close to home (ie somewhere where your experience, enthusiasm and expertise will help the project) and are more likely to address causal vs symptomatic issues.

9. Are you interested in a Venture Philanthropy approach to high engagement philanthropy?

To what extent will the Foundation be wanting to invest in projects or in teams or programmes? Morgan (2206) mentions issues of donor fatigue, but non-profit organisations also suffer from funding application fatigue, which induces a compliance cost burden, a deflection of effort away from the agency's core mission and an inducement to focus on the short term. My advice would be to go down the start-up approach. Invest your time, money and effort in developing a team and organisation that will generate benefits beyond the foundation's involvement.

10. To what extent do you wish to devote resources to measurement and evaluation?

Measurement and evaluation are not functions that are done well within the philanthropic sector and it is something that is important for the Foundation to address. However, there are both practical and conceptual factors that make it difficult to measure and evaluate philanthropic activities accurately. This means that a degree of pragmatism will be needed for determining the amount of time, effort and resources devoted to this task.

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